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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000769

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TAGS: [EPET](#) [ENRG](#) [PREL](#) [PGOV](#) [AJ](#) [KZ](#)

SUBJECT: BP OFFICIALS ON FUTURE TRENDS IN THE EAST-WEST  
ENERGY CORRIDOR

REF: BAKU 736

Classified By: Charge d'Affaires Jason P. Hyland, reasons 1.4 (b), (d)  
and (e).

11. (C) SUMMARY. On May 17, BP Azerbaijan Associate President David Woodward and BP Executive Vice President Andy Inglis briefed Charge and British Ambassador on recent developments in Caspian energy projects. BP has reached closure with BOTAS on a deal for BTC completion. Woodward and Inglis feel that labor relations are becoming more important, and may be manipulated by a GOAJ eager to deflect criticism. Looking at future projects, Woodward and Inglis advise an incremental, piece-by-piece approach, as was done with BTC. While they welcomed President Aliyev's recent move to put Western-oriented, English-speaking officials into key positions, Woodward and Inglis said that both SOCAR and the GOAJ continue to suffer from an extreme capacity deficit, particularly in the area of oil revenue management. Woodward and Inglis feel this will ultimately affect the political environment, perhaps producing new opposition movements outside of the traditional opposition parties. END SUMMARY.

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BTC AND SCP: NOT TROUBLE-FREE BUT WORLD CLASS  
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12. (C) Woodward began the meeting by reviewing the current state of the BTC and SCP projects, noting that the work on both has been truly "world-class." Although BTC itself has been delayed, the drilling platforms at both Western Azeri and Eastern Azeri (parts of the Azeri-Chirag-Gunashli, or ACG, field which feeds BTC) arrived ahead of schedule. Regarding BTC completion, following a "tough conversation" with Turkish state pipeline company BOTAS, Woodward feels confident enough to say that both sides have arrived at a mutually acceptable agreement for completion. This will include a payment by BP and increased BP control over aspects of completion. Woodward believes that Azerbaijan will agree to the deal and hopefully final approval by all partners will be achieved by the end of May. While BP is not completely happy with how things turned out, Woodward said that BP "has to be big about this" and remember that it is looking at a forty-year relationship with the host countries on this project.

13. (C) This does not mean an end to problems with BTC, added Woodward. In some cases, and especially with Georgia, BTC's difficulties may be "only just starting." Woodward noted that labor relations are beginning to emerge as an issue, citing the recent strike at McDermott and the various incidents revolving around alleged mistreatment of Azerbaijani flags or commemorations of the Khojaly Massacre. In the background, said Woodward, there is always rhetoric about "expatriates sitting around the Hyatt swimming pool giving away our money;" he said that GOAJ figures like Finance Minister Sharifov are often the prime source of such remarks. At this, Inglis remarked that while Sharifov sees the big picture, he loves to haggle.

14. (C) Charge and British Ambassador agreed that labor relations will assume greater and greater importance. Inglis pointed out that while certainly there were real grievances in recent labor disputes, it would be "simplistic" to assume that the situation was not also being manipulated. Woodward pointed out that recent labor actions had not occurred on projects that were coming to an end where people are losing their jobs, but on projects that are continuing. Charge speculated that the GOAJ may try to channel and control these currents of discontent. Inglis agreed: "The honeymoon is over."

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FUTURE PROJECTS: WILL AZERBAIJAN REST ON ITS LAURELS?  
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15. (C) Inglis said that there are several questions to think about when considering what comes next in Caspian energy. What does Azerbaijan's resource base really hold? How much

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of this does Azerbaijan want to commit to projects now, and how much does it want to save for later? How will unemployment be dealt with during the lull between projects? The issue of sustainability, and the issue of transitioning to a workforce composed of a larger and larger percentage of local employees, also need to be considered. With regards to gas export projects specifically, Inglis said that Azerbaijan has yet to fully understand that it does not face a trade-off between satisfying domestic demand for gas and being a major gas exporter to Europe. It is possible for Azerbaijan to achieve both goals, he argued.

16. (C) Woodward opined that things might be better for BP if it were not for the "wall of money" about to hit Azerbaijan as a consequence of BTC and SCP. Elements of the GOAJ, pleased with high oil and gas prices, seem ready to rest on their laurels and less likely to seize opportunities to press ahead with new projects. Additionally, Woodward said that state oil company SOCAR will want to play a larger and more active role in future projects. BP does not object to this, said Woodward, but there are serious questions about SOCAR's capabilities. In Woodward's opinion, SOCAR does not have the capacity to take the leading role on future projects.

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STEP-BY-STEP: THE LESSON OF BTC  
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17. (C) When considering future projects, such as Caspian gas export, Woodward feels the experience of BTC is instructive. Woodward recalled four factors that had to come together to make BTC happen:

- A commercial imperative (a product to be sold and a market for it).
- A finite number of host countries for the project that are serious about it.
- The strong backing of the United States and allied governments.
- Breaking the project down into "bite-sized chunks."

¶8. (C) Woodward stressed the fourth point: Caspian energy has succeeded because its associated projects have been accomplished incrementally. BTC itself, involving three countries, was a fairly large piece - but Woodward noted that it was manageable. If the BTC project had originally included Kazakhstan as well, he pointed out, it likely would have been too ambitious to accomplish. Instead, the project first focused on bringing Azerbaijan's oil through Georgia to Turkey. Then, as that was accomplished, a new project of bringing Kazakhstan's oil across the Caspian by ship to BTC could be considered. Inglis strongly agreed - an incremental approach vice a "big bang" is the best way to proceed. COMMENT: This echoed the approach recommended by SOCAR Vice President Elshad Nasirov in reftel, although Nasirov's view was driven more by concerns about Russia.

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CAPACITY-BUILDING CRITICAL  
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¶9. (C) On politics, both Woodward and Inglis spoke positively of recent changes in the GOAJ and how Ilham Aliyev is bringing Western-oriented, English-speaking officials to the fore. The next question, said Woodward, is to what extent Ilham Aliyev can take on the remaining members of the old elite. Inglis pointed out that Azerbaijan is in better shape than many other countries where BP has projects, such as Angola, but capacity issues are still of profound importance. Charge noted that the GOAJ's poor performance on avian flu is a good example. British Ambassador pointed out that there are countries, such as Belarus or Uzbekistan, where the West has essentially given up on the possibility of progress. Azerbaijan is not in that category yet, he said.

¶10. (C) The fate of the BP-funded, Oxford-designed macroeconomic policy model for oil revenue management is an example of Azerbaijan's "thanks, we'll do it ourselves" attitude, says Woodward - the GOAJ is dragging its feet on

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implementation. Inglis pointed out that Azerbaijan will have no capacity to plan how to spend its oil revenues most effectively without such a model.

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POLITICS POST-BTC COMPLETION  
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¶11. (C) Woodward said that the inability to manage oil revenues will have implications as the general public sees certain individuals getting richer and richer while elsewhere in society there is no progress. Opposition to the ruling party may emerge, but Woodward does not believe this will come from the existing opposition parties. It is more likely to arise anew from the grassroots, from the Islamic sector of society, or from disaffected members of the ruling elite.  
HYLAND